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IN THE

Supreme Court of the United States

October Term, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, as Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania,
Respondents.

REPLY BRIEF FOR PETITIONER.

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REPLY BRIEF FOR PETITIONER.

The argument contained in respondents' brief includes new matter conflicting directly with every position heretofore taken by respondents in this case, and other matter which similarly appears to call for reply by petitioner.

1. As to the Newly Asserted "Illegality" of a Portion of the Deposit.

For the first time in this case respondents advance the position that the basis for dividends to petitioner should be $62,500 only, on the theory that the deposit should not have been more than one-half of the depository bond. (Respondents' brief, pp. 10-14). There are, we believe, two clear answers to this position.

In the first place, decisional authority is to the contrary, for it shows that statutes such as those of Pennsylvania contained in respondents' brief and the appendix thereto, setting up requirements to control the relation of public deposits to the security therefor and to the capital of the bank,

have been enacted and are to be construed for the benefit of the public and *not of the bank.*

In *Capital Savings and Loan Association vs. Olympia Nat. Bank,* 80 F. (2d) 561 (C. C. A. 9, 1935) a *depositor* sought to enjoin a national bank receiver from paying further dividends to the State Treasurer of Washington on the ground, inter alia, that the security deposited with the treasurer was not as great as that required by the State statute and that the deposit was not in required relation to the capital and surplus of the bank. In affirming the dismissal of the Bill, the Circuit Court there said (p. 567):

> "Nor can the appellants complain that the state treasurer did not exact from the bank greater security, so that the state's deposit would be either seventy-five or ninety per cent of the amount pledged. That provision, we repeat, is for the protection of the state and not of the bank; for if the state treasurer had exacted even more security than he in fact received, the assets of the bank would have been further depleted by that much and the general creditors would be in worse situation than they now are.
>
> "To summarize our views under this heading therefore we hold that the appellants are entitled to invoke the state statutes for the purpose of ascertaining whether *any* security for public deposits is permitted by state law, and, if so, what kind, but not for the purpose of questioning the size of the public deposit or the *amount* of security given by the bank; for the provision of state law as to the amount of security or of public deposits are for the protection of the state and not of the banks."

Secondly, the position has its direct and continuous refutation in all the positions taken by respondents themselves throughout the instant case. *Before* the suit was begun the respondents first paid the Commonwealth a divi-

dend of 40% upon $135,000 and then recognized the petitioner as "subrogee of the deposit claim due the Commonwealth of Pennsylvania by the Bethlehem National Bank" (R. 9, Letter of Receiver to petitioner of July 11, 1936) and also recognized the deposit as having been "assigned" to the petitioner (R. 8, Letter of Receiver to petitioner dated December 23, 1935), and in the earlier instance treated the $135,000 deposit as the valid original base. In the case of the second letter (R. 9)the Office of the Comptroller of the Currency himself was quoted as having directed the use of the $68,588.56 basis for petitioner's dividends. A basis of $62,500 for dividends, as a basis equal to one-half the face of petitioner's bond, was never mentioned. The respondents' Answer speaks for itself, as their position *after* suit was begun (R. 11):

> "Paragraph 15. It is admitted that the plaintiff claims as alleged in this paragraph, but the *defendant contends* that the plaintiff is only entitled to be reimbursed *on the basis of the amount paid by the plaintiff to the Commonwealth.*" (Italics supplied)

Here was *affirmative contention* for a basis of $68,588.56 advanced in the trial Court by the respondents, and of course therefore treated in the decisions of both the trial Court (R. 14) and the Circuit Court (R. 27) as the respondents' position upon the issue of dividend basis. Of course also, no cross-petition for certiorari was filed in this Court on any basis, the Circuit Court having adopted the respondents' own said specific contention on that issue.

Therefore we contend that both the law and the record of this case defeat this new position of respondents. Reference may be made further to the reasoning enlisted by respondents under its head. Seeking, apparently, to make out that petitioner is a claimant against "innocent third parties" while itself guilty of negligence, respondents now suggest that subrogation should not attach (Respondents' brief, p. 13). First, wherein was petitioner "negligent"? Re-

spondents say frankly that they do not by any means suggest that petitioner "participated in, or in any way was causally responsible for, the making of said illegal deposits" (Ibid., pp. 12, 13); yet they say petitioner was negligent in not "supervising" the deposit account "to the extent of being kept constantly informed as to the balance thereof". There is no factual showing whatever in this record that petitioner did or did not procure that information, and therefore there is no factual foundation for the argument. Supposing nevertheless that petitioner did not procure it, surely the failure to avail of a simple possibility of information is not negligence where it is plain that the information could not be acted upon if procured. And, in the same connection, where is the "innocent party"? If petitioner had had the information it could not have restrained the State Treasurer of Pennsylvania from making excess deposits *or the respondent bank from accepting or retaining them.* That seems clear upon the decision in the *Capital Savings* case, supra, and also upon the statement of the Supreme Court of Pennsylvania o the subject of the statutes of 1897 and 1906 set forth by respondents (Brief, p, 11), in *Commonwealth v. Caldwell* 224 Pa. 103, 112, that "The purpose of this act was to throw around the state treasury additional *safeguards as a protection to the public funds".* It is the *respondent bank* that is the negligent and wrongful party here, in truth, because petitioner was helpless to control the deposit amounts but respondent was perfectly free to decline to receive them. Respondents say that petitioner's claim for dividends upon $135,000 is a result of the *making* of illegal deposits (Respondents' brief, p. 13). Rather, we submit, it is the result of the *acceptance* of such deposits by the respondent bank, for no deposit could have been made had respondent declined it.

Thus, we submit that the new position of respondent upon the basis of "illegality" amounts to no more than a statement by respondents as follows in effect: "We are telling you now that we accepted from the Commonwealth de-

posits making possible and actual the State treasurer's evasion of statutory requirements. We thus procured public monies for our own investment profit without the need for yielding up our capital assets as collateral, or paying higher suretyship premium, to secure them. We have not only enjoyed this double advantage by participating in an evasion of the statutes which you, the surety, could not prevent, but we have also recognized the whole deposit for the purpose of the dividend of 40% to the Commonwealth and have availed ourselves of your liability upon your bond and have seen you pay $68,588.56 upon that deposit out of your own funds. Subsequently we have joined issue with you, and forced you to litigate to last resort, upon an express theory on our part that you are entitled to dividends on the sum you so paid rather than on the deposit. Now, in the last resort, we tell you that we may pay you nothing, or that at most we ought to pay you upon $62,500, *because*, as we tell you now, we evaded the law for our profit in the past. We propose a premium upon our own evasion, in the form of saving in bond charges before and a reduction in our liquidation obligation now. You should have found us out before, though you could not have acted upon your information if you had, since the statute we evaded is for the protection solely of the public whom you have made whole agreeably to your promise."

The Commonwealth having been made whole and the *respondent bank* having been itself the wrongdoer in the transaction which thus worked out without loss to the public interest intended by the statute to be protected, there appears to be no room in this case for the maxim that where loss is sustained affecting two innocent parties the one making it possible should suffer it. (Respondents' brief p. 14)

2. As to the Payment for the Depository Bond.

Respondents are correct in observing, at page 14 of their brief, that the District Court mistakenly stated (in passing) that the Commonwealth paid for the depository

bond. Respondents are *not* correct in stating that petitioner in any way adopted this mistake in the petition for certiorari. Petitioner does not rely upon any such proposition of fact, nor—respondents' assumption at page 16 of their brief to the contrary notwithstanding—did the District Court. That part of the District Court's reasoning urged upon this Court in our petition for certiorari (p. 15) makes no mention of payment for the bond and in no way relies upon it. The Court said (R. 16, 17):

> "On the whole, it seems to me that, if the real objective of the doctrine of subrogation be kept in mind, we come closer to distributing the loss fairly and avoiding unjust enrichment of any interest by allowing the surety to claim on the basis of the full amount of the creditor's claim. By so doing it may be possible to reimburse him fully, and still do entire justice to the general creditors—for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement with which they had nothing to do and which was purely fortuitous so far as they are concerned. To hold otherwise would really be to deny the surety subrogation altogether."

Respondents then argue that, the bank having paid for the bond, for a "presumed purpose" of meeting a contingency of receivership, the bond should be treated as an *asset* of the bank in receivership. This argument, we submit, totally ignores the fact and runs directly counter to law. As to the fact, there seems no need for presuming a purpose. The plain purpose of the bond, so far as the Commonwealth was concerned, was the security of public deposits and, so far as the bank was concerned, was the procurement of the Commonwealth's funds so that the bank might invest them and profit thereby for its own account. As to the law, we submit that any argument which converts

a liability into an asset answers itself. The case of *United States Fidelity Company v. Wooldridge*, 268 U. S. 234, 238, cited by respondents at page 16 of their brief, related to a bond securing the fidelity of the president of the bank. Thus the bank there was *creditor* in the bond, whereas here the bank was principal *debtor* upon the bond. All of which, we submit, supports the reasoning of the District Court (R. 16, 17) that the depositors had nothing to do with this bond and same was not in any wise for their benefit.

Respondents undertake then to mark the depository bond as part of the receivership estate, the trust res for creditors. Could the bank *sue* upon the bond? On the contrary, the bank could have been sued upon it, had petitioner not paid the creditor named in it. And as it was not an asset of the bank, so it cannot be constructed into an asset of the bank's estate after it has been performed If the bank had secured the Commonwealth by pledging its capital assets instead of by suretyship, that collateral would have been the property of the Commonwealth to the extent of the debt, and the partial payment of the debt by the sale of that collateral would have been immaterial to the dividend basis. When the bank escapes the necessity for surrendering its capital assets, by the use of the alternative of suretyship, why should the creditor's realization by suretyship be any more material to the bank's obligation to pay its date-of-insolvency obligation by liquidating dividends on its amount?

Respondents further say, at page 25 of their brief, that they do not owe petitioner $135,000, and, at page 17 thereof, that payment of dividends upon $135,000 would cut into the bank's estate to the prejudice of the other creditors. *Petitioner is not asking payment of $135,000 to itself.*[1] It is asking simply that the estate pay to it *the*

[1] Respondents cite numerous cases holding that the sovereign right to preference in insolvency does not pass to the sovereign's subrogee. No such right is claimed in the present case, and no such question is involved.

exact amount remaining unpaid by the bank on its date-of-insolvency debt of $135,000, namely, $68,588.56, by the medium of dividends on that debt of $135,000. The date-of-insolvency deposit balance, according to the reasoning of this court in *Merrill v. National Bank of Jacksonville,* 173 U. S. 131, 19 S. Ct. 360, 43 L. Ed. 640, must be the only claim on this deposit account cognizable by the receiver to the end of liquidation. Thus, instead of prejudicing other creditors, the use of that basis for dividends represents precisely what all creditors should and must have expected. Therefore, substitution of petitioner to that primary debt by subrogation at once follows out the *Merrill* case principles and avoids, rather than involves, violence to the fixed ratio of all creditors' interests in the estate.[2]

3. As to the Fact That Petitioner Was a Compensated Surety.

Respondents suggest in effect that because petitioner was a compensated surety it ought to the fullest conceivable extent to suffer loss. The cases cited for such a policy of discrimination against paid sureties (Respondents' brief, pp. 21, 22) appear to relate to release of surety obligations by departure from original contract terms. In the instant case no such point is involved, for there is no effort to avoid the suretyship. On the contrary, it has been honored

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[2] The Fourth Circuit Court relied upon the *Merrill* case in holding the surety "*undoubtedly entitled*" to subrogation to the primary debt, in *Fouts v. Maryland Casualty Co., 30 F. (2d) 357.* Respondents, at page 35 of their brief, call this holding dictum because the Court there was denying a different quantum of dividend recovery to the plaintiff surety. But where a Court denies one quantum *because* the *only* right (subrogation to the primary debt) is otherwise, certainly the Court is *deciding* the "only right", and not merely referring to it as dictum. Certainly the lower court in the *Fouts* case would be bound, upon the Circuit Court's opinion in it, to extend to the surety subrogation to the primary debt.

and performed, and the only question is the medium of salvage. All that the surety claims is that that medium should be the date-of-insolvency debt of the debtor, consistently with the *Merrill* case principle fixing the bank's obligations in liquidation exclusively upon the quantum and ratio of debt existing at that date.

If it is true that in some situations the compensated surety is not the favorite of the law, neither, we submit, need he be made its scapegoat. Truly, if it were the policy of the law not only to guard against a paid surety's *release* from obligation, but, even where he has *performed* his obligation, to visit upon him the greater loss because he had before receivership made a small premium profit, even such policy must have been fairly accommodated in the present case. Here the petitioner has already suffered an irrecoverable loss, entirely apart from dividends, in the sum of interest on the deposit after insolvency paid by the petitioner to the Commonwealth (R. 13—$2,150.34). Here also the prospective further loss by failure of future dividends is great, respondent bank having paid to date, by always decreasing dividends, only 75% upon its date-of-insolvency debt.

4. As to the Case of Merrill v. National Bank of Jacksonville, 173 U. S. 131.

Respondents point out, at page 24 of their brief, that the claimant in the *Merrill* case was the secured creditor of the national bank and not, as here, his surety. This has always been clear. Our argument derives from the *Merrill* case not because petitioner pretends to be the secured creditor but because of the reasoning of this Court there seems to us to require the result reached by the District Court here. There the holding was that the secured creditor was entitled to dividends on the full amount of the deposit without deduction of amount realized from collateral held for it. *For what reason?* Because to be "ratable" dividends must be on a uniform rule, applicable to all alike as

at *the same date* . . . the date of the closing of the bank, after which no new debt could be created. *That reasoning, we submit, requires that the account in question here, the $135,000 deposit account of the Commonwealth, be the basis of dividends to the end of liquidation,* whether they be payable to the Commonwealth or a successor to its position by assignment or subrogation. Otherwise, a new debt, in the sum the petitioner *happens* to pay after insolvency, is created in contravention of the principle that rights and proportions are fixed at date of insolvency. That such debt has nothing to do with the debt structure of the bank at date of insolvency seems manifest from the fact that its time and amount are not at all within the control of the bank but can be contrived and managed by the creditor and the surety after insolvency. If in the instant case the petitioner had used every means to keep the Commonwealth in the position of claimant, the Commonwealth concededly would be entitled to the dividends on $135,000 awarded by the District Court to petitioner as its subrogee. Does the *reasoning* of this Court in the *Merrill* case cease to apply to this national bank liquidation, so as to permit a *change* in the quantum and proportion of date-of-insolvency debt, simply because petitioner came forward and *performed a bond which the depositors could not enforce, and performed it at a time and to an amount bearing no relation whatsoever to their previously vested proportions in the bank's estate?*

Respondents suggest, at pages 25 and 26 of their brief, that "there is no res" to which petitioner can be subrogated, the Commonwealth having been made whole. It seems sufficient to answer that the exact reverse is the law. Unless and until the subrogor is made whole, subrogation cannot be had, because to allow it would allow the subrogee to compete with the creditor he has undertaken to secure. The respondents' own quotation, at page 8 of their brief, from the opinion of this Court in *American Surety Co. v. Westinghouse Electric Manufacturing Co. et al.*, 296 U. S. 133, 137, is complete authority upon the principle.

In concluding reply petitioner respectfully urges upon this Court the *omission* marking respondents' brief. In reversing the District Court's award to petitioner of dividends upon $135,000 the Circuit Court below reasoned that the loss of depositors was their deposits and the loss of petitioner was its payment of $68,588.56 upon the depository bond, and that they should share upon the basis of these losses. We have advanced argument, at page 6 of the petition, Reason 3, pages 17 and 18 of the brief annexed to the petition, and page 6 of petitioner's brief, that the Circuit Court's decision is seriously in error even if the dividend basis adopted by it were correct, because its decision left wholly out of account the coefficient essential to ratability, i. e. *percentage of dividend*, and thus would leave petitioner with 35% in dividends in a situation where admittedly the depositors have received 75% on deposits. To our said argument in chief we add the point that respondents have not undertaken to answer any part of it. *If*, therefore, the dividend basis of $68,588.56 adopted by the Circuit Court below were correct, respondents, by their silence, evidently agree with us that *ratability could be achieved with it only by awarding petitioner 75% of that base.*

The consistent, legally certain and true solution, we contend, is that reached in the District Court below, causing the receiver thereby simply to *complete the payment of the bank's $135,000 debt*—no more and no less—by payment of dividends on the sum of that debt until the $68,588.56 portion *yet unpaid by the bank* upon it shall have been paid.

Respectfully submitted,

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